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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

TX 2006-050063 07/31/2008

HON. THOMAS DUNEVANT, III

CLERK OF THE COURT
S. Brown
Deputy

SCOTTSDALE CITY ERIC C ANDERSON

v.

TERRABROOK MIRABEL LLC DAWN R GABEL

FRANK V CROCIATA

UNDER ADVISEMENT RULING

(Plaintiff City of Scottsdale's Motion For Summary Judgment Re: Speculative Builder Sales; Plaintiff City of Scottsdale's Motion For Summary Judgment Re: Construction Contracting; Defendant Terrabrook Mirabel's Motion For Summary Judgment, Rule 56; and Defendant's Motion To Exclude Testimony Of Jonathan Stansel)

The facts briefly are as follows. Defendant Terrabrook Mirabel is a planned community in Scottsdale. The lots are sold without homes; however, certain infrastructure work, such as road construction and grading (itself necessitating additional work for drainage and to salvage and replace native vegetation adjacent to the roadway), the installation of utility stubouts, and construction of amenities such as a clubhouse, was performed prior to sale. The City assessed taxes based on the theory that the infrastructure work, which impinged on the undeveloped lots, constituted either erection of a "structure" or "improvements" to land containing no structure, either of which would subject Plaintiff to taxation pursuant to Scottsdale Tax Code (STC) § 416. Subsequently, the City advanced an alternative theory, that if Plaintiff was not a speculative builder, it must be a construction contractor, subject to taxation under STC § 415. The present motion practice includes motions for summary judgment filed by the City on each of these theories, as well as a single motion for summary judgment filed by Defendant.

Defendant's Motion and Plaintiff's Motion Re: Speculative Builder Sales cover essentially the same ground, so will be dealt with together.

The Court preliminarily affirms the principle laid down most eloquently by the renowned Judge Learned Hand. "[A] transaction, otherwise within an exception of the tax law, does not lose its immunity, because it is actuated by a desire to avoid, or, if one choose, to evade, taxation. Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934). The City does not suggest that the construction practices of Mirabel are without economic substance, such that they are to be disregarded by the Court. If Mirabel has found what the City considers a "loophole" in the Scottsdale Tax Code and operates within it, the remedy is to go to the City Council and request that the Code be suitably amended. The Court applies the Code as it exists to Mirabel's operations as they occurred.

It is useful to begin by referring to the definitions section of the statute. Scottsdale City Tax Code (STC) § 100 defines a "speculative builder" as "either (1) An owner-builder who sells or contracts to sell, at anytime [sic], improved real property (as provided in Section 416) consisting of: (A) Custom, model, or inventory homes, regardless of the stage of completion of such homes; or (B) Improved residential or commercial lots without a structure; or (2) An owner-builder who sells or contracts to sell improved real property, other than improved real property specified in subsection (1) above: (A) Prior to completion; or (B) Before the expiration of twenty-four (24) months after the Improvements of the real property sold are substantially complete." Only subsection (2)(A) can apply here. "Improved real property" is further defined by STC § 416(2) as "any real property: (A) Upon which a structure has been constructed; or (B) Where improvements have been made to land containing no structure (such as paving or landscaping); or (C) Which has been reconstructed as provided by Regulation; or (D) Where water, power, and streets have been constructed to the property line." Neither party asserts that (C) or (D) applies.

The application of § 416(2)(A) depends on the definition of "structure." The City is correct that "structure" is a broader term than "building," but its breadth is not unlimited. Instructive is *Lewis v. Midway Lumber, Inc.*, 114 Ariz. 426, 430 (App. 1977), which distinguished among "building," "structure," and "improvement." A "building" "has been defined as an edifice constructed for use or convenience as a house, church, shop, etc., attached to and becoming part of the land." *Id*. (following *Rabb v. W.P. Ellison, Inc.*, 99 A. 119, 120 (N.J. 1916)). A "structure" is something such as a fence or billboard. *Id.* An "improvement" is "a valuable addition or betterment to real estate such as a building, clearing, drain, fence, etc." *Id*. (following *Interstate Lumber Co. v. Rider*, 19 P.2d 644, 646 (Mont. 1933)).

The critical distinction seems to be that a building or a structure is something *erected upon* the land for an independent purpose, as opposed to an improvement, which may be a building or a structure (such as a fence, which *Lewis* specifically listed as both a structure and an

improvement) but may instead be a *rearrangement of* or *appropriation of* the land to make it better serve a building or structure; this would include utility infrastructure, such as a drain, which *Lewis* listed as an improvement but not as a structure, and paving, identified in subsection (B) as an improvement and so necessarily not a structure under subsection (A). Berms, drainage ditches, routes for buried utility lines and the like, such as were created on Mirabel's lots, are if anything improvements, not structures. The City urges a broad definition of "improvements" to include "constructed objects," which it equates with "structures." But this interpretation would render § 100(1)(B), which presupposes the existence of improved lots without a structure, an oxymoron: an improved lot without a structure cannot exist if an "improvement" by definition is a "structure." An interpretation that so negates the statutory language cannot be correct. In addition, this interpretation has the potential to make redundant subsection (D), which requires that water lines *and* power lines *and* streets be extended to the property line; by the City's definition, subsection (A) would always apply if any one of the subsection (D) elements existed and some trace of the work can be found across the line. Under the facts here, subsection (A) does not apply.

Which leaves subsection (B). The crucial question is whether the work physically performed *on* the lots constitutes improvements – "valuable addition[s] or betterment[s]," continuing to follow the guidance of *Lewis, supra – to* the lots. The City's interpretation with regard to the native plants is troubling. As explained in its Motion for Summary Judgment Re: Speculative Builder Sales, "Before any grading work began, Mirabel was required [by the City] to remove, box, and salvage protected native plants that were likely to be destroyed during development and to replant those plants pursuant to its landscaping plans where possible…. This work changed the natural landscape along the front of each lot and the removal of these plants constitutes work such as landscaping, especially when those plants are required [by the City] to be boxed and salvaged for re-planting, as they were here." The City's position is that, because its own permitting regulations for the road required the removal and replanting of flora located on the lots which would be damaged by the road work, just by building the road (or, as the City suggested in oral argument, utility lines), Mirabel was inescapably subjected to the Section 416 tax. Again, this is inconsistent with subsection (D), which requires that water and power lines as well as the road extend to the property line; indeed, by the City's interpretation, even the road need not reach the property line, only approach close enough for its construction to imperil native plants on the other side.

Section 416 requires that the lots and the infrastructure be treated as distinct and subsection (B) imposes tax only if improvement is made to the lots. The Court must therefore determine whether the work done in fact resulted in improvement to the lots. The bulk of the work plainly did not. The situation here can be compared to a construction easement on the lots as servient tenements for the benefit of the dominant tenement, the road (though, as Mirabel owns both the dominant and the servient tenements, no easement exists in law). There is no

basis in the record to conclude that the servient tenements, the lots, have been themselves made more valuable or more conducive to home building by the work performed for the benefit of the road, and the Court finds no indication in the statutory language that either the authors of the Model City Tax Code (MCTC) or the Scottsdale City Council intended that an improvement be presumed. It is not material that the lots are made more valuable by having a road in convenient proximity: it is the work itself, not the future benefit from the infrastructure, that must result in improvement.

The City's argument that landscaping results *per se* in taxation under subsection (B) fails. The subsection requires that the work performed on the lots, whatever it is, constitute an improvement to the lot; paving and landscaping are offered as examples ("such as") of activities that could result in taxable improvement. The City has not demonstrated that the plants were replaced in substantially different positions than they occupied before the road construction, let alone that they were given new locations for the purpose of enhancing the landscaping ambience of the lots rather than accommodating the disturbances caused by the road grading. That the same plants were not replaced in precisely the same spots is not sufficient to constitute an improvement. Section 416(2) cannot be read so broadly as to subject a builder to the speculative builder tax merely because its construction of infrastructure has a non-valuable impact on the undeveloped lots, especially when the impact results from regulations imposed by the taxing authority on the building of the infrastructure.

The City's attempt to equate the buyers' easement in the common areas with equitable ownership is not consistent with Arizona law. An easement is a nonpossessory interest, conferring on its holder only the right to use property owned by another. *Clark v. New Magma Irrigation & Drainage District*, 208 Ariz. 246, 249 ¶ 12 (App. 2004). It does not confer title or ownership, either legal or equitable.

The broader question of whether any subsection (B) improvements, valuable additions or betterments, were made to the lots themselves is a more difficult question. It is not material that the work was done for the purpose of building the road: the statute looks at results, not intent. Nor can the Court find a *de minimis* exception in the statute: it is immaterial that the value of the improvement is small compared to the total value of the lot. There is evidence in the record that at least some of the grading was not strictly obligated by the needs of the roadbuilders or the engineering mandates of the City, but anticipated what would eventually be required by the homebuilder to smoothly connect his individual driveway to the road. There is also evidence that utility lines may in at least some cases have extended beyond the property line (to a distance sufficient to exclude a mere surveying or placement error), with the similar purpose of making connection by the ultimate homebuilder less destructive and costly. Either of these would seem to add value, constituting an improvement and subjecting Plaintiff to tax under subsection (B). If this can be established (or refuted) by motion practice, the Court might be in a position to rule as

a matter of law. As neither side has adequately developed this perhaps unexpectedly crucial aspect of the record, it cannot yet do so.

The City's argument that, if Mirabel did not engage in speculative building under the language of the statute, it must be a contractor subject to tax on that basis, appears to be new: not only have there been few if any previous attempts to impose a tax on this theory, the City concedes that no attempt was made to collect it from Mirabel. The Court cannot agree with the City's suggestion that, because *Estancia Dev. Assocs. v. City of Scottsdale,* 196 Ariz. 87 (App. 1999), is only one case, it does not reflect an "established interpretation" such as to trigger Section 542. The Court is not aware of any rule that an appellate court holding must be reiterated some particular number of times to become established; it has always assumed that once is enough. As Section 542 would bar the imposition of the construction contractor tax upon Mirabel in this case, it is not necessary to make the further factual inquiry that would be required to determine whether Mirabel was in fact acting as a construction contractor.

Therefore, IT IS ORDERED:

1. Denying Defendant's Motion To Exclude Testimony Of Jonathan Stansel.

2. Denying Plaintiff's Motion For Summary Judgment Re: Construction Contracting.

3. Denying Both Defendant's Cross-Motion For Summary Judgment and Plaintiff's Motion For Summary Judgment Re: Speculative Builder Sale.